Speech to Alcan Aluminum Plant Managers
February 18, 2003

Introduction

Thank you for the invitation to speak to you today regarding the topic of electricity. This is a critical time for the nation and the state in terms of what is happening in our electricity markets. As participants in the aluminum industry, you are probably more keenly aware of these changes than many others across the nation. With the energy intensive nature of your business, and the huge amount of your overhead that is dedicated just to paying for the energy you use, I know you are extremely sensitive to even the most subtle of changes in electricity markets.

The Kentucky Public Service Commission is the state agency that regulates not just electricity, but also natural gas, water, sewer, and telecommunications industries in Kentucky. As Chairman of this agency, I work to ensure that utility rates are fair, just and reasonable, and that service is safe, adequate and reliable for all utility customers in the state. I, along with two other commissioners, not only watch and make decisions on utility issues within the state of Kentucky, but we also monitor issues and policies being shaped nationally. When necessary, we participate in cases at the Federal Communications Commission and at the Federal Energy Regulatory Commission (FERC), which is responsible for regulating national wholesale electricity and natural gas markets, as well as other forms of energy.

In the brief comments I will share with you today, I want to hit two major points. First, we'll talk electricity rates. Second, I will talk about why those rates may be in danger, and why we need to act now to protect Kentucky's low cost power advantage. After my brief comments, I will open the floor for questions, and give you an opportunity to share your concerns regarding electricity with me.

First – let's talk rates.

Not long ago, the Kentucky PSC conducted a review of the adequacy of Kentucky's generation capacity and transmission system. The study was set up in response to the influx of merchant plants planning to locate in Kentucky. We wanted to know what the current state of the system was, as well as how the system would be affected if these additional projects were to be built in the state. In the final order in this administrative case was issued in December of 2001, and it identified the average retail rates for the calendar year 2000.

A comparison with rates on a national and regional basis demonstrated that Kentucky enjoys a competitive advantage with its electricity rates – not just for the consumer, but also for economic development opportunities for attracting new industry and jobs to the Commonwealth. Kentucky's average rates for all sectors combined were 12 percent below the regional average, and 23 percent below the national average in 2000. Kentucky's average residential rates were 5.5 cents per kilowatt hour. That 5.5 cents compares to an average of 7.3 cents per Kwh for the region, and an average 8.2 cents per Kwh for the nation. Industrial rates in Kentucky were an average 3.9 cents per Kwh, compared to an average of 4.2 cents per Kwh for the region, and 4.5 cents per Kwh for the nation.

I recently received a chart that showed the purchased power costs for Kentucky for Generation and Transmission. The chart displayed purchased power costs by utility, and ranged from 4.8 cents per Kwh for TVA power to 3.0 for Kentucky Utilities. (The anticipated costs for projects proposed for TVA were 5.1 cents per Kwh.) Again, these prices are among the lowest in the nation and even the world. And as you are well aware, even a small deviation from these prices can mean millions of dollars difference in overhead expenses for large industrial customers.

Second Point – Kentucky's low cost power may be in danger!

And that brings me to the second part of my discussion today – and that is our concern that Kentucky's low cost power may be in jeopardy.

As you are probably aware, FERC has embarked on a great quest to develop robust national wholesale electricity markets. We in Kentucky are certainly not opposed to the development of such markets. You may have noticed that here in the Commonwealth, we have an abundance of natural resources: a great deal of coal, and access to some major natural gas pipelines. As I have already discussed, our utilities can generate electricity more cheaply than anywhere else in the nation currently, and we in Kentucky enjoy some of the lowest rates for electricity in the entire world. We, as energy policy makers for the state, realize that a robust wholesale electricity market may allow utilities, independent power producers, coal producers and others in our state to realize significant profits through the sale of Kentucky's cheap electricity outside the state. However, the dilemma is how do we allow the development of this wholesale market without causing the price of electricity to increase for Kentucky's electricity customers.

The wholesale market manipulation and resulting energy fiasco in California not only cost customers and businesses in that state millions of dollars above and beyond what could be described as reasonable energy costs, but also affected regulated states in the Northwest that had enjoyed a history of low-cost power. Washington and Oregon both saw their low-cost power evaporate and electricity prices skyrocket as the unintended consequences of California's restructuring effort spilled across state lines. Kentucky is surrounded by deregulated states, and careless deregulation efforts and ill-conceived wholesale market development could bring a similar fate to our state.

The Federal Energy Regulatory Commission (FERC) is making decisions daily that affect electricity consumers across the nation, in both regulated and non-regulated states. Currently, FERC has several open cases that will establish market rules for regional electricity markets throughout the nation. In addition to individual cases, FERC is attempting to establish through a formal rulemaking process, a set of standard market rules that will dictate the operation of electricity markets across the nation – in both retail regulated and de-regulated states. Through its decisions, FERC has clearly demonstrated its lack of concern for ratepayers in regulated states, and continues to make decisions that will cause regulated, captive ratepayers to subsidize the development of a wholesale market from which they will receive no benefit.

In its proposed standard market rules, FERC attempts to usurp state commission jurisdiction over regulated retail electricity service, and therefore remove our state's ability to protect its own ratepayers. Kentucky has the lowest rates in the nation, and among the lowest rates in the world. This fact is one of our most important economic development advantages. An increase in electricity prices, particularly to pay for services that Kentucky customers will not use, is an unfair shifting of responsibility, and one that could seriously affect the bottom line of businesses and households throughout the state. For highly competitive businesses like aluminum smelters, the difference in the bottom line could be a fatal blow to their already thin margins.

Another and more immediate concern is if FERC decides to implement market rules for our region outside the scope of the SMD rulemaking. FERC currently does have a case open and may rule this week on market rules for utilities under the membership of the Midwest ISO – the RTO operating throughout much of the midwest region. Inside of this case, MISO has asked for unlimited blank check spending to create this wholesale market. Furthermore, they have asked that all ratepayers, both regulated and unregulated, have to pay these costs through adders on electricity bills.

It is imperative that we act now. We must do everything we can to ensure that the Commonwealth's electricity customers are protected from price increases, and decreasing reliability of our electricity system. We must ensure that we are not required to pay more for our electricity so customers in other states can lay claim to our cheap and reliable power. We are certainly not opposed to the development of a robust wholesale market, one in which Kentucky's power producers can sell excess power outside of the state at a considerable profit. However, we do oppose the development of that market through subsidies paid by regulated retail customers. We must act now, and do everything we can to ensure that our voice is heard in Washington.

Conclusion

In conclusion, I want to mention that as we have been fighting this standard market design initiative with FERC, we have been in constant communication with other government agencies, as well as utilities and consumer groups throughout the state. One of the groups has been Kentucky's Industrial Utility Customers under the representation of Mike Kurtz. KIUC filed initial comments in the SMD docket at FERC. We have had a great deal of cooperation among all interests in the state on this issue, as it could so dramatically affect Kentucky.

Once again, thank you for the opportunity to speak to you today. I appreciate the invitation, and hope I have provided you with some useful information. I will be happy to take your questions at this time, or to hear what thoughts you may like to share with me on this issue, or other utility issues that may be of concern to you.